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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.

Telephone Number:

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LEGEND:

Settlor =
Trust =

Child A =
Child B =
Child C =
Attorney A =
Attorney B =
Date =
State =
Local Court =
Cite 1 =

Cite 2 =

Cite 3 =

Cite 4 =

Cite 5 =

Cite 6 =

Dear :

This is in response to your authorized representative's letter dated September 14, 2006, and subsequent correspondence, requesting rulings on the federal estate tax consequences of a judicial modification of Trust.

The facts and representations submitted are as follows. Settlor established Trust, an irrevocable trust, on Date. Child A is designated as the trustee. Trust is governed by the laws of State. References in Trust to Settlor's children are to Child A, Child B, and Child C.

Article III, Section 1, of Trust, provides, in part, that during Settlor's life, the trustee "shall" pay to or apply for the benefit of Settlor's descendants as much of the net income and principal of the trust as the trustee deems necessary or advisable for their education, health, maintenance, and support. In making distributions, the trustee shall take into consideration, to the extent the trustee deems advisable, any income or other resources of beneficiaries outside the trust and known to the trustee. The trustee may make distributions to or for the benefit of one or more of the beneficiaries to the complete exclusion of the others, and in equal or unequal proportions, according to their respective needs as those needs arise.

Article III, Section 2, provides that during Settlor's lifetime, Settlor's youngest then living descendant may appoint the principal of the trust to any persons or corporations or other entities other than Settlor, the holder of the power, the holder's estate, the holder's creditors, or the creditors of the holder's estate.

Under Articles IV, V, and VI, the Trust property not disposed of during Settlor's life is to be divided into equal shares with one share for each then living child of Settlor and one share for each deceased child of Settlor who has then living descendants. A living child's share is to be distributed outright to the child. A share for a deceased child with then living descendants is to be distributed to or for the descendants, per stirpes.

Upon subsequent review of the Trust provisions, and after a recent court opinion was rendered construing mandatory and discretionary trust provisions under State law, it appeared that Settlor's use of the word "shall" in the first sentence of Article III, Section 1 (i.e., the trustee "*shall* pay . . . income and principal") could be interpreted by a court as requiring the trustee to make mandatory distributions to the Trust beneficiaries. [Emphasis supplied.] Cite 1. Settlor represents, in a sworn affidavit, that she intended to grant the authority to make distributions in the trustee's absolute discretion as he deemed necessary. In sworn affidavits, Attorney A (who prepared the initial draft of Trust) and Child A (as trustee) concur with Settlor's affidavit.

It is also represented that Settlor intended to grant the power of appointment over the Trust principal, created in Article III, Section 2, to her youngest child (i.e., Child A).

However, due to a scrivener's error, the word "descendant" was used instead of the word "child," with the result that the power was granted to Settlor's youngest living descendant. At present, that person is a minor, who is unable to exercise the power.

To correct the mistake and clarify any ambiguity, the trustee will file a petition with Local Court requesting an order approving the following modifications:

- (1) The word "shall" in the first sentence of Article III, Section 1, is replaced with the word "may" to provide that "During Settlor's life, the Trustee may pay to or apply for the benefit of Settlor's descendants . . .;" [Emphasis supplied.] and
- (2) The word "descendant" in the first sentence of Article III, Section 2, is replaced with the word "child" to provide that: "During Settlor's lifetime, the Settlor's youngest then living child may appoint . . ." [Emphasis supplied.]

You have asked us to rule that, as a result of the judicial reformation of Trust, the assets of Trust will not be includible in Settlor's gross estate under section 2033, 2035, 2036, 2038, or 2041 of the Internal Revenue Code.

State law

Under State law, reformation is generally permitted where the evidence clearly and unequivocally shows that an instrument does not express the true intent or agreement of the parties. Reformation is also appropriate where the variance between the instrument and the true agreement of the parties is caused by the draftsman. Cite 2; Cite 3. Moreover, the clear intent of the parties is to be given greater regard than the possibly inept choice of words. Cite 4; Cite 5.

Federal law

Section 2001(a) provides that a tax is imposed on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2033 provides that the value of the gross estate shall include the value of all property to the extent of the interest therein of the decedent at the time of death.

Section 2035(a)(1) and (2) provide that if the decedent made a transfer (by trust or otherwise) of an interest in any property, or relinquished a power with respect to any property, during the 3-year period ending on the date of the decedent's death, and the value of the property (or any interest therein) would have been included in the decedent's gross estate under sections 2036, 2037, 2038, or 2042 if the transferred interest or relinquished power had been retained by the decedent on the date of death, the value of the gross estate shall include the value of any property (or interest therein) which would have been so included.

Section 2036(a) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in case of a bona fide sale for an adequate and full consideration in money or money's worth), by trust or otherwise, under which the decedent has retained for life or for any period not ascertainable without reference to the decedent's death or for any period which does not in fact end before the decedent's death: (1) the possession or enjoyment of, or the right to the income from, the property, or (2) the right, either alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 20.2036-1(b)(3) of the Estate Tax Regulations provides that the phrase "right ... to designate the person or persons who shall possess or enjoy the transferred property or the income therefrom" includes a reserved power to designate the person or persons to receive the income from the transferred property, or to possess or enjoy non-income producing property, during the decedent's life or for any period not ascertainable without reference to the decedent's death or for any period which does not in fact end before the decedent's death. With respect to the a power, it is immaterial (i) whether the power was exercisable alone or only in conjunction with another person or persons, whether or not having an adverse interest; (ii) in what capacity the power was exercisable by the decedent or by another person or persons in conjunction with the decedent; and (iii) whether the exercise of the power was subject to a contingency beyond the decedent's control which did not occur before the decedent's death (e.g., the death of another person during the decedent's lifetime).

Section 2038(a)(1) provides that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has at any time made a transfer (except in the case of a bona fide sale for adequate and full consideration in money or money's worth), by trust or otherwise, where the enjoyment thereof was subject at the date of death to any change through the exercise of a power (in whatever capacity exercisable) by the decedent alone or by the decedent in conjunction with any other person to alter, amend, revoke, or terminate the interest in the property or where the decedent relinquished the power during the 3-year period ending on the date of the decedent's death.

Under section 2041(a)(2), the value of the gross estate includes the value of all property to the extent of any property with respect to which the decedent has at the time of death a general power of appointment, or with respect to which the decedent has at any time exercised or released the power of appointment by a disposition which is of the nature that if it were a transfer of property owned by the decedent, the property would be includible in the decedent's gross estate under section 2035 to 2038, inclusive.

Section 2041(b)(1) provides that the term "general power of appointment" means a power exercisable in favor of the decedent, the decedent's estate, the

decedent's creditors, or the creditors of the decedent's estate.

Section 2041(b)(2) provides that the lapse of a power of appointment during the life of the individual possessing the power shall be considered a release of the power.

Analysis

In Commissioner v. Estate of Bosch, 387 U.S. 456 (1967), the Court considered whether a state trial court's characterization of property rights conclusively binds a federal court or agency in a federal estate tax controversy. The Court concluded that the decision of a state trial court as to an underlying issue of state law should not be controlling when applied to a federal statute. Rather, the highest court of the state is the best authority on the underlying substantive rule of state law to be applied in the federal matter. If there is no decision by that court, then the federal authority must apply what it finds to be state law after giving "proper regard" to the state trial court's determination and to relevant rulings of other courts of the state. In this respect, the federal agency may be said, in effect, to be sitting as a state court.

In this case, the documentation submitted strongly indicates that: (a) Settlor intended to relinquish all control over the assets in Trust; (b) the distributions to Settlor's descendants, as provided for in Article III, Section 1, were intended to be made in the trustee's discretion; and (c) the power of appointment provided for in Article III, Section 2, was intended to be granted to Settlor's youngest living child rather than Settlor's youngest living descendant.

Based on the facts submitted and the representations made, we conclude that the court order, described above, clarifying the distribution provision of Article III, Section 1, and correcting the scrivener's error of Article III, Section 2, will be consistent with applicable State law, as applied by the highest court of State. Cite 6.

Consequently, we conclude that as the result of the judicial reformation of Trust: (1) Settlor will not have retained any interest in the Trust property for purposes of section 2033; (2) Settlor will not have released, transferred or relinquished any retained interest or power that would subject the Trust assets to inclusion in Settlor's gross estate under section 2035; (3) Settlor will not have retained, for life, the right, either alone or in conjunction with any person, to designate who will possess or enjoy the property or income from the Trust within the meaning of section 2036; (4) Settlor will not have retained a power, either alone or in conjunction with another person, to alter, amend, revoke, or terminate the reformed trust within the meaning of section 2038; and (4) Settlor will not have possessed a general power of appointment, as defined under section 2041, with respect to Trust.

Accordingly, if Trust is reformed pursuant to the terms of the court order described above, we conclude that the value of the property in Trust, as reformed, will

not be includible in Settlor's gross estate under section 2033, 2035, 2036, 2038, or 2041.

The rulings contained in this letter are based upon information and representations submitted by Settlor and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as specifically ruled herein, we express or imply no opinion on the federal tax consequences of the transaction under the cited provisions or under any other provisions of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Pursuant to the power of attorney on file, we are sending a copy of this letter to your authorized representative.

Sincerely yours,

George Masnik
Chief Branch 4
Office of Associate Chief Counsel
(Passthroughs and Special
Industries)

Enclosure
Copy for section 6110 purposes